

ST 99-32

Tax Type: Sales Tax

Issue: Responsible Corporate Officer – Failure to File or Pay Tax

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS**

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS)	
)	
v.)	Docket No. 98-ST-0000
)	IBT # 0000-0000
“JOHNNY JONES”, as responsible officer of)	NPL # 0000
“ABC, Inc.”,)	
Respondent)	

RECOMMENDATION FOR DISPOSITION

Appearances: Jim Day, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Douglas S. Lake of Baker, Lake & Chiligris for “Johnny Jones”

Synopsis:

The Department of Revenue (“Department”) issued a Notice of Penalty Liability (“NPL”) to “Johnny Jones” (“respondent”) pursuant to section 13½ of the Retailers' Occupation Tax Act (“ROTA”) and section 3-7 of the Uniform Penalty and Interest Act (“UPIA”)¹. The NPL alleges that the respondent was an officer or employee of “ABC, Inc.” (“corporation”) who was responsible for wilfully failing to pay the corporation's retailers' occupation taxes (“ROT”) and use taxes. The respondent timely protested the

¹ For the portion of liability incurred during 1993, the relevant provision was Ill.Rev.Stat., ch. 120, par. 452½. For the liability incurred during 1994, this section had been replaced by section 3-7 of the UPIA (35 ILCS 735/3-7).

NPL, and an evidentiary hearing was held.² After reviewing the record, it is recommended that the liability be affirmed.

Findings of Fact:

1. On February 25, 1998, the Department issued NPL number 6809 to the respondent that proposed a total penalty liability of \$66,296.09, including tax, interest, and penalty, for failure to pay sales taxes for the following months: June, July, August, September of 1993 and March, April, May of 1994. The NPL was admitted into evidence under the certificate of the Director of the Department. (Dept. Ex. #2).

2. The respondent was a guarantor of the debts and leases of the corporation. (Tr. Pp. 12, 25)

3. The respondent owned 41% of the corporation's stock. (Dept. Ex. #4, p. 10)

4. For the taxable periods at issue, the respondent had authority to sign checks. (Dept. Ex. #4, Tr. Pp. 36-37)

5. In late August of 1993, the respondent was aware that the corporation was experiencing financial hardship. (Tr. P. 39)

6. In November of 1993 the corporation filed a Chapter 11 bankruptcy petition. In May of 1994 the case was converted to a Chapter 7 bankruptcy. (Tr. Pp. 11-13)

7. During the bankruptcy proceedings, the respondent was the assistant secretary of the corporation. During this time period the respondent filed and signed tax returns and signed checks for the payment of taxes. (Dept. Ex. #4, p. 10; Tr. Pp. 16-17)

8. The respondent had control of the corporation's books and records from September 1993 through March 1994. (Dept. Ex. #4, p. 10)

² The hearing was held by Administrative Law Judge (ALJ) Chris Higgerson. Mr. Higgerson is no longer employed as an ALJ; therefore this recommendation was written by ALJ Linda Olivero.

9. The respondent acknowledged that the corporation was receiving revenues before the bankruptcy was filed, and respondent was aware that other creditors were being paid. (Tr. P. 43-44)

Conclusions of Law:

Section 13½ of the Retailers' Occupation Tax Act provides in part as follows:

"Any officer or employee of any corporation subject to the provisions of this Act who has the control, supervision or responsibility of filing returns and making payment of the amount of tax herein imposed in accordance with Section 3 of this Act and who wilfully fails to file such return or to make such payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the corporation, including interest and penalties thereon;" Ill.Rev.Stat. 1991, ch. 120, par. 452½ (now 35 ILCS 735/3-7(a))³.

An officer or employee of a corporation may therefore be personally liable for the corporation's taxes if (1) the individual had the control, supervision or responsibility of filing the ROT returns and paying the taxes, and (2) the individual willfully failed to perform these duties.

For guidance in determining whether a person is responsible under section 13½, the Illinois Supreme Court has referred to cases interpreting section 6672 of the Internal Revenue Code (26 U.S.C. §6672)⁴. See Branson v. Department of Revenue, 168 Ill.2d 247, 254-56 (1995); Department of Revenue v. Heartland Investments, Inc., 106 Ill.2d 19, 29-30 (1985). These cases state that the critical factor in determining responsibility is whether the person had significant control over the corporation's finances. See Purdy Co. of Illinois v. United States, 814 F.2d 1183, 1186 (7th Cir. 1987) Responsibility is

³ The following is the relevant part of section 3-7 of the UPIA: "Any officer or employee of any taxpayer subject to the provisions of a tax Act administered by the Department who has the control, supervision or responsibility of filing returns and making payment of the amount of any trust tax imposed in accordance with that Act and who wilfully fails to file the return or make the payment to the Department or wilfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the taxpayer including interest and penalties thereon." (35 ILCS 735/3-7(a)).

⁴ This section imposes personal liability on corporate officers who willfully fail to collect, account for, or pay over employees' social security and Federal income withholding taxes.

generally found in high corporate officials who have control over the corporation's business affairs and who participate in decisions concerning the payment of creditors and the dispersal of funds. Monday v. United States, 421 F.2d 1210, 1214-1215 (7th Cir. 1970), cert. den. 400 U.S. 821.

In addition, these cases define "wilfull" as involving intentional, knowing and voluntary acts or, alternatively, reckless disregard for obvious known risks. See Branson at 254-56; Heartland at 29-30. Wilfull conduct does not require bad purpose or intent to defraud the government. Branson at 255; Heartland at 30. Willfulness may be established by showing that the responsible person (1) clearly ought to have known that (2) there was a grave risk that the taxes were not being paid and (3) the person was in a position to find out for certain very easily. Wright v. United States, 809 F.2d 425, 427 (7th Cir. 1987). Furthermore, whether the person in question wilfully failed to pay the taxes is an issue of fact to be determined on the basis of the evidence in each particular case. Heartland at 30; Department of Revenue v. Joseph Bublick & Sons, Inc., 68 Ill.2d 568, 577 (1977). Courts have found that giving preferential treatment to other creditors rather than paying the corporation's taxes constitutes wilfull behavior. See Heartland at 29-30.

Under section 13½, the Department's certified record relating to the penalty liability constitutes *prima facie* proof of the correctness of the penalty due.⁵ See Branson at 260. Once the Department presents its *prima facie* case, the burden shifts to the respondent to establish that one or more of the elements of the penalty are lacking, i.e., that the person charged was not the responsible corporate officer or employee, or that the

⁵ The relevant portion of section 13½ provides as follows: "The Department shall determine a penalty due under this Section according to its best judgment and information, and such determination shall be *prima facie* correct and shall be *prima facie* evidence of a penalty due under this Section. Proof of such determination by the Department shall be made at any hearing before it or in any legal proceeding by reproduced copy of the Department's record relating thereto in the name of the Department under the certificate of the Director of Revenue. Such reproduced copy shall, without further proof, be admitted into evidence before the Department or any legal proceeding and shall be *prima facie* proof of the correctness of the penalty due, as shown thereon." Ill.Rev.Stat. 1989, ch. 120, par. 452½.

person's actions were not wilfull. Id. at 261. In order to overcome the Department's *prima facie* case, the allegedly responsible person must present more than his or her testimony denying the accuracy of the Department's assessment. A. R. Barnes & Co. v. Department of Revenue, 173 Ill.App.3d 826, 833-34 (1st Dist. 1988). The person must present evidence that is consistent, probable, and identified with the respondent's books and records to support the claim. Id.

In the present case, the Department's *prima facie* case was established when the Department's certified record relating to the penalty liability was admitted into evidence. In response, the respondent first claims that for the 1993 liability periods the Department has failed to put forth evidence that the respondent had control over the payment of the sales taxes.

Unfortunately, the respondent is the one with the burden of proof and the evidence does not support the respondent's claim. The respondent must present evidence identified with the respondent's books and records showing that the respondent did not have control over the payment of the taxes. The only documentary evidence presented concerning the 1993 liability period was articles of incorporation that showed that the respondent was not an officer of the corporation. The respondent was, however, a 41% shareholder and a guarantor of the corporation's debts. The "responsible person" liability refers to any person who has the authority to direct which creditors are to be paid, and this liability may even be extended to stockholders. See Carella v. Tomlinson, 66-2 USTC 9517 (1966) (in some instances stockholders may be responsible persons). Nevertheless, the respondent only presented the articles of incorporation and his own self-serving testimony that he was not in control of the finances during the 1993 liability period. This evidence is insufficient to overcome the Department's *prima facie* case because it was incumbent upon the respondent to present evidence other than his own testimony showing that he did not have significant control over the corporation's finances. The respondent could have provided corroborating testimony or documents

such as a signature card from the bank showing the respondent did not have authority to pay bills during this period. Although the respondent may not have been in control of the corporation's finances during the 1993 liability period, it was necessary to submit documents supporting this conclusion. Without other evidence, it must be found that the respondent was a responsible person for this time period. The fact that the respondent knew that other creditors were being paid during this period supports a finding that he wilfully failed to pay the taxes.

The same conclusion must be reached concerning the liability incurred during March, April, and May of 1994. The only documentary evidence for this time period were documents showing the monthly income and cash flow statements for December, January, February, and March of the bankruptcy period. Although the information for March of 1994 includes a check made payable to the Department for state withholding taxes, nothing indicates that the ROT liability was paid. In addition, once the bankruptcy petition was filed, the respondent became the assistant secretary of the corporation and was responsible for filing the sales tax returns and paying the taxes. The taxes were not discharged in bankruptcy. (See 11 U.S.C. 523). Therefore, the respondent was responsible for paying the taxes. Although the respondent claims that the corporation ceased operations sometime during March or April of 1994, no documentary evidence was submitted to support this conclusion.

Recommendation

For the foregoing reasons, it is recommended that the Notice of Penalty Liability be upheld.

Linda Olivero
Administrative Law Judge

Enter: 10/26/99

